The European Union's Common Agricultural Policy: Pressures for Change—An Overview

Provision for the Common Agricultural Policy (CAP) was integral to the agreements that established the European Union (EU) and the CAP has been among the most important EU policies administered and funded in common. Revisions or "reforms" of the CAP have been numerous, in response to dramatic changes in agricultural realities and circumstances since the 1960s. This article contends that the continuing need for revision results significantly from the interventionist nature of the CAP, which manages agricultural prices, precluding automatic market-directed adjustments of production and consumption to changing circumstances. Strong vested interests will continue to limit reforms, allowing revisions only when the immediate political costs of not reforming equal or exceed the costs of reform. *[Gene Hasha (ghasha@econ.ag.gov)]*

The Importance of the Common Agricultural Policy

The European Union (EU) [1] is the world's largest agricultural importer—and the world's second largest exporter. Agricultural production, consumption, and trade in the EU are strongly influenced by government programs and policies. Over the last 30 years, the Common Agricultural Policy (CAP) has brought about a massive reversal in the agricultural trading position of the EU, transforming the world's largest importer of temperate-zone agricultural products into the world's second largest exporter of food and agricultural products. During the 1980s, U.S. agricultural exports faced increasing competition from subsidized EU exports. The U.S. share of world wheat trade peaked at 45 percent in 1981, after averaging over 40 percent in the previous decade. Since 1989, the U.S. share has averaged less than 27 percent. The EU share of world wheat trade was 21 percent in 1981, but has averaged almost 30 percent since 1989.

Although unsubsidized EU exports of some products have increased in recent years, particularly in times of high prices, the CAP continues to insulate much of EU agriculture from world market forces. This insulation largely exempts EU producers and consumers from adjustments required in the global agricultural sector and increases the adjustments imposed on countries with open agricultural markets. The CAP has significantly affected all countries that depend on agricultural trade, and it remains a dominant influence on international agricultural markets and trade.

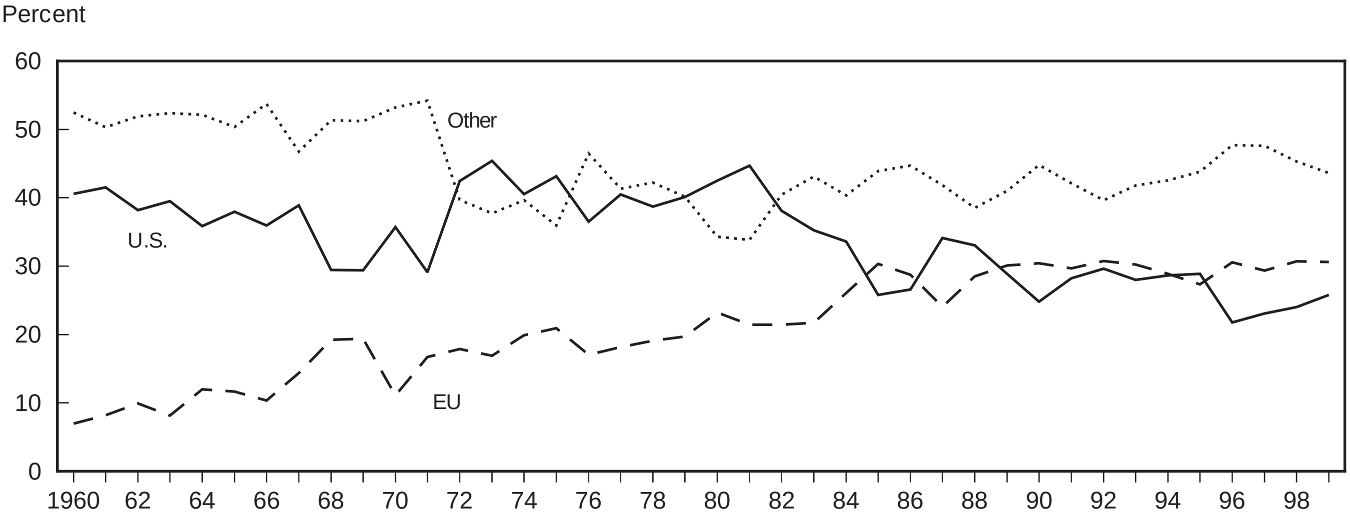
[1] The European Economic Community (EEC) was created by the Treaty of Rome in 1957. In 1967, the EEC was integrated with the European Atomic Energy Community and the European Coal and Steel Community to form the European Communities (EC). The Treaty of Maastricht established the European Union (EU) in 1992. The original six member countries were West Germany, France, Italy, the Netherlands, Belgium, and Luxemburg. The United Kingdom, Ireland, and Denmark joined in 1972. Other countries joined subsequently: Greece (1981), Spain and Portugal (1986), and Sweden, Finland, and Austria (1995).

In March 1999, The EU adopted important changes in the CAP as part of a reform package known as "Agenda 2000." The reforms adopted were less far-reaching than those adopted by the Council of Agricultural Ministers in the previous year, which in turn were less substantial than the original reform proposals of the EU Commission presented in July 1997. Nonetheless, the reforms that were finally adopted are significant. The Commission has identified numerous pressures for CAP reform, which are presented below and considered in greater detail in the articles that follow.

Analyses of Agenda 2000 policy changes presented below suggest that the policy pressures identified will require, eventually, more far reaching reforms than those recently adopted. A lack of immediacy—particularly regarding EU enlargement and a WTO agreement, which are at least a few years away—appears to have diminished appreciation of the longer-term political and economic costs of not adopting more fundamental CAP reforms. The lack of immediacy has thereby limited the scale of politically feasible reforms at this time.

Agenda 2000 is foremost a proposal for EU finances, non-agricultural as well as agricultural. It replaces current arrangements expiring in 1999 with a new financial framework for 7 years through 2006. The foremost focus of Agenda 2000 is the budget challenges presented by enlargement of the EU to include countries in Central and Eastern Europe (CEE) beginning as early as 2002. The prominence of the CAP in Agenda 2000 follows from its role in the EU budget—CAP budget costs amounted to over $47 billion in 1997 and accounted for about 50 percent of all EU expenditures. The CAP accounted for as much as two-thirds of the budget in the 1980s. Agenda 2000 addresses numerous agricultural problems seen as results of the current CAP. Analysis of Agenda 2000 in this report details the expected growth in EU surpluses. Analysis of EU enlargement outlines the extent to which enlargement is expected to compound EU surplus problems. Agenda 2000

Figure 1
Major Wheat Exporters, Shares of World Trade



Source: Economic Research Service, USDA.

also seeks to prepare EU agriculture for upcoming WTO negotiations. The analysis below identifies ways in which Agenda 2000 reforms are likely to affect EU positions in WTO multilateral trade negotiations.

The Origins and Essential Character of the CAP

The essential character of the CAP was determined by the circumstances surrounding its inception in the late 1950s. The Treaty of Rome provided for a common agricultural policy that would: 1) guarantee food supplies at stable and reasonable prices; 2) ensure a fair standard of living for farmers, and 3) improve agricultural productivity through technical progress and develop more rational production systems that would employ resources more efficiently. Those goals reflected widespread rural welfare problems, the relative backwardness of agricultural production in many areas, and a perceived need for secure food supplies following shortages that persisted for nearly a decade following World War II. Agriculture also presented a large “agricultural vote,” employing a large proportion of the working population in most European countries, over a quarter in France, Italy, and Luxembourg (Bowler, Ian R.). The CAP adopted for the original six members was consistent with the highly interventionist and protective policies previously maintained by the individual members. Those policies reflected the depression conditions of the 1930s and the tight regulations imposed during World War II, although most EU countries had highly protective regimes to support agriculture even before the twentieth century. (Bureau of Agricultural Economics).

The CAP was based on three fundamental principles: 1) free trade within the Community based on common prices, 2) preference for Community produce in Community markets, and 3) joint financial responsibility. Employing a variety of mechanisms, the original CAP provided support generally by maintaining stabilized internal prices well above world prices for unlimited quantities of most products. CAP mechanisms insulated domestic markets from world market forces, exempting EC producers and consumers from the adjustments that otherwise would have been required. Import levies also provided substantial revenues for the EU budget.

Support regimes varied, but for the major products, including grains, milk products, and beef and veal, support involved variable import levies, unlimited intervention purchasing at guaranteed price levels, and variable export subsidies or taxes as required. Production controls were found necessary as early as 1968 for sugar. By the early 1970s, the variety of other measures adopted included deficiency payments for oilseeds, minimum import prices and purchasing of surpluses for fruits and vegetables, and subsidies for distilling surplus wine.

Changing Circumstances Shape Evolution of the CAP. During its nearly 40 years, the CAP has achieved much toward its original objectives. Those successes and other dramatic changes in agricultural, political and other circumstances have changed fundamentally the nature of EU agricultural policy deliberations. Most important has been a technological revolution that greatly increased production. Ample EU food supplies have been assured. However, because CAP mechanisms generally control prices, precluding adjustments in production and consumption in response to changing market prices, chronic surpluses also have resulted. Structural surpluses led to significantly changed political circumstances as budget costs increased rapidly and international conflicts arose with other agricultural exporters.

The technological revolution also has brought specialization and concentration in EU agriculture, and four decades of economic growth have greatly reduced the role of agriculture in overall EU income and employment. Farm household incomes also have improved dramatically, equaling or surpassing non-farm incomes in most EU countries. (Buckwell, Allan et al). Collectively, these changes have eliminated the post war “peasant” character of EU agriculture in most regions. Of the CAP’s original objectives, only “reasonable” prices and efficient resource use can be considered still at issue.

Other changes in the circumstances of EU agriculture have shaped changes in the CAP. Three enlargements of the EU have increased the diversity of agricultural conditions and politics. In recent years, public concerns for the environment, food safety, and animal welfare have played a growing role in agricultural policy deliberations and, along with budget costs, have added a negative aspect to the public view of agriculture. The complexity and arbitrary nature of CAP regulations and programs also have generated dissatisfaction, even among farmers.

A strong parallel can be drawn between the EU today and the United States before adoption of the Federal Agriculture Improvement and Reform Act (FAIR) in 1996. Until then, U.S. agricultural policy maintained a strong continuity with policies originally adopted in the 1930s in response to depression conditions and an agricultural structure that was similar in many ways to post-war Europe (Young, C. Edwin and Paul C. Westcott). Modernization radically transformed the structure and productivity of agriculture in the EU and the United States since World War II. Surpluses resulting from the lack of a process allowing market-directed adjustments eventually led both policy systems to introduce production controls. In 1996, the United States abandoned supply controls for major agricultural products and reduced significantly price support for program crops.

The Fundamental Pressure for CAP Reform: Surpluses

High Prices, Technological Progress, and Surpluses. Since the 1960s, the most important change affecting the CAP has been a revolution in productivity that transformed the EU from a large importer of most agricultural commodities to a major exporter of temperate-zone products. High and stable prices have encouraged investment, restructuring, and rapid and continuous adoption of modern production technology. High prices also limited growth in EU demand. Given CAP mechanisms, the inevitable result was the emergence of surpluses. As early as 1969, one-sixth of the EU wheat crop had to be denatured, making it unfit for human consumption, and subsidized for feed use in an attempt to balance supply and demand. By the early 1980s, the EU had large surpluses of most temperate-zone agricultural products and emerged as a major exporter. Since the 1980s, surplus production or “market imbalances” and the large attendant budget costs for export subsidies have been identified repeatedly as the fundamental problems prompting numerous reforms of the CAP. The Treaty of Rome’s goal to modernize EU agriculture and increase productivity was fully achieved. However, the lack of mechanisms allowing market-directed adjustments of production and consumption to changing conditions turned technological success into the CAP’s enduring surplus disposal problem.

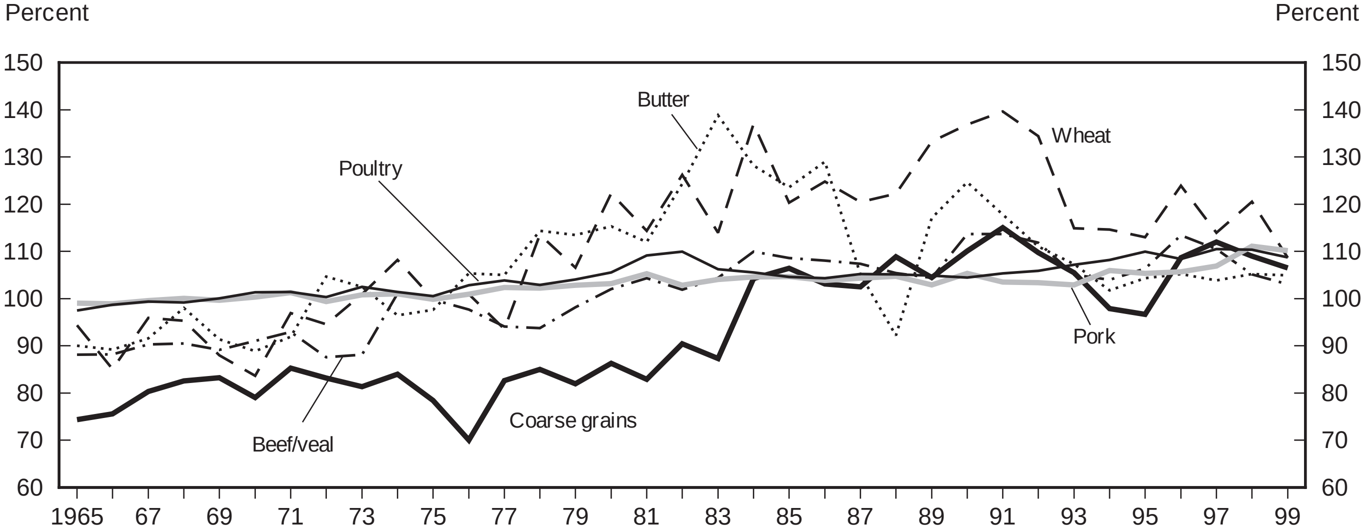
Budget Costs. When the EU was a net importer of most agricultural goods in the earliest years of the CAP, the EU budget benefited from substantial import levy revenues while the cost of agricultural support provided through high internal prices fell mostly on consumers. Concerned with food security, consumers showed little reaction to high prices. However, the emergence in the 1980s of surpluses for most products presented a new problem—surplus disposal. The EU has disposed of some surpluses through subsidies for extraordinary domestic consumption, but subsidized exports have accounted for the bulk of surplus disposal. Surpluses also made the CAP a very costly policy. Not only did the EU lose import levy revenues, but subsidies required for export have been large because EU prices have been much higher than world prices. EU prices were lowered after 1992, reducing per-unit and total export subsidies, but farmers received direct payments to compensate for lost sales revenues, more than offsetting reduced budget costs for export subsidies. A significant part of the cost of agricultural support was transferred from consumers to taxpayers.

The budget cost of direct payments has increased significantly, accounting for 70 percent of all EU expenditures for market support and direct aids in 1996 and causing total spending on agriculture to increase 28 percent from 1991 to 1997. Benefits to farmers increased much less than budget increases, since direct payments mostly offset reduced prices. EU budget costs for agricultural market support and direct aids remain high, amounting in 1997 to almost 41 billion ECU (over $46 billion) , over half of the total EU budget. Agenda 2000 provides for a CAP budget of only 41.7 billion Euros by 2006, roughly equivalent to current expenditures. [2] If adhered to, Agenda 2000 will end the growth in the EU agricultural budget.

International Relations and Commitments. Also associated with agricultural surpluses was another important change surrounding the CAP—increased conflict among world agricultural exporters. During the 1980s, weak international demand and lack of a production response to changing circumstances in exporting countries led to persistently low international commodity prices. Global market problems were widely attributed to domestic support policies that generated structural surpluses and the subsequent reliance on

[2] 1 Euro = 1 ECU at its adoption on January 1, 1999. US$1 = .953 Euro during September 1999.

Figure 2
EU Self-Sufficiency

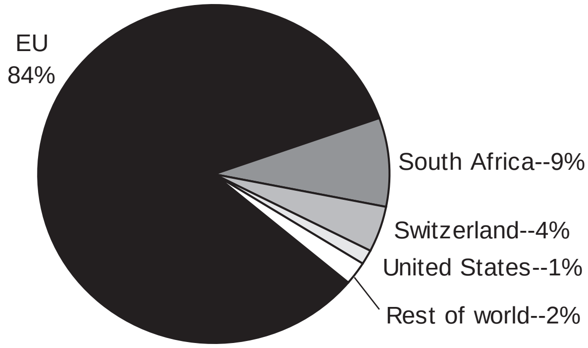


Source: Economic Research Service, USDA.

subsidized exports to dispose of them. The EU was the principal source of subsidized exports. The United States adopted significant export subsidies under the Export Enhancement Program (EEP) beginning in 1985, originally as a political and practical response to EU export subsidies.

Eventually, in the Uruguay Round Agreement (URA) of the General Agreement on Tariffs and Trade (GATT), the EU and other countries agreed to reductions and permanent limits on subsidized export volumes and total subsidy amounts. The EU still uses export subsidies on a scale vastly greater than all other countries, accounting for 83 percent of world agricultural export subsidies reported to the WTO in 1996 (Leetmaa, Susan E. and Karen Z. Ackerman). The potential for future unsubsidized EU exports is presented in analyses of Agenda 2000 proposals that follow.

Figure 3
WTO Export Subsidy Notifications (Value), 1996



Source: Economic Research Service, USDA.

Opposition to CAP Reform: Vested Interests

Among the multiple goals originally proclaimed for the CAP, stable and politically acceptable farm incomes have proven to be the paramount concern of EU policymakers. The political sensitivity of farm incomes results from the reality that the share of the EU civilian work force employed in agriculture has always been far larger than the share of gross domestic product (GDP) attributable to gross value added in the agricultural sector. Agriculture employed 12 percent of the EU-9 workforce in 1968 but accounted for only 6.3 percent of GDP. Without supplemental non-farm income or agricultural transfers, the incomes of farm households would have been significantly less than those of non-farm households.

The role of agriculture in total EU income and employment has declined dramatically since the inception of the CAP. The EU farm population has declined an average of 3 percent annually since 1968, although the decline has been more rapid in recent years, 4.5 percent annually from 1986 to 1996. However, agriculture's contribution to GDP also has continued to decline, by more than employment in percentage terms. EU agriculture employed just over 5.1 percent of the EU-15 work force in 1996, but accounted for only 1.7 percent of GDP. Nonetheless, EU farm household incomes, including agricultural subsidies and income from non-agricultural activities, have been raised to parity or better in relation to non-farm incomes in almost all EU countries. Increased off-farm employment has played an important role, but the contribution of transfers associated with the CAP remains prodigious.

EU budget expenditures on agriculture alone are large, but budget expenditures do not include transfers from consumers through high prices. The Producer Subsidy Estimate (PSE) calculated by the Organization for Economic Cooperation and Development (OECD) is an indicator of the value of all monetary transfers to agriculture resulting from agricultural policies in a given year, including market price support resulting from domestic prices that are above world levels. In 1998, the total PSE for all products in the EU was valued at almost US$130 billion, compared to almost US$47 billion for the United States. OECD calculations attributed 45 percent of all EU producer receipts to policy transfers, compared to 22 percent in the United States (OECD). Policy transfers would account for a much larger proportion of farm income net of production costs.

While changing circumstances have produced continuing pressures for change in the CAP, its beneficiaries have consistently and effectively resisted reforms that would significantly reduce the CAP's large policy transfers to agriculture. Even though the EU agricultural population has declined, the farm population still constitutes a critical "agricultural" vote in many EU countries and the large benefits accruing to farm interests have made them active political partisans in most EU countries. CAP benefits have become progressively more concentrated on a smaller percentage of farmers that are relatively wealthy, reducing public support for the CAP as a source of assistance to needy farmers. The relatively smaller benefits accruing to a larger number of small farmers remain important to those farmers, however, sustaining important political support for the CAP.

The benefits of the CAP (and the EU) are, for some countries, financed by other member countries through the EU budget. Those national advantages associated with the CAP are important political elements in all CAP reform deliberations. EU programs benefiting less-developed rural and regional areas are cornerstones of EU policy and the CAP. Contributions to the EU budget are based partially on GDP, also assuring that poorer EU countries benefit from EU programs, including the CAP. The Mediterranean countries and Ireland have been the principal beneficiaries of CAP and other EU programs. However, more developed countries with relatively large agricultural sectors (e.g. France, the Netherlands, and Denmark) also benefit.

Where there are winners, there also are losers who generally support CAP reforms. Germany, and, to a lesser extent, the United Kingdom have been the principal net contributors to the EU budget. Germany's political position as principal EU paymaster has been complicated by its particularly strong political need for high prices that results because German farms are relatively small and German non-farm incomes are relatively high. Of course, EU livestock producers and agricultural processors are disadvantaged by high feed and raw product prices. Less tangible, but always far from unimportant in the political balance is the CAP's role as the principal "common" policy of the EU, as reflected in the CAP's claim on the EU budget. The integrity of the CAP has been equated by some with the integrity of the essential political fabric of the EU itself.

A Selected History of CAP Reforms

Surpluses and growing budget costs have provoked numerous CAP changes, adjustments, and special measures. These adaptations generally have been referred to as "reforms," although not everyone agrees that the changes necessarily were for the better. Pressures for reform have been strongly associated with conditions on world markets. Global shortages in the mid-1970s accompanied by high world prices actually facilitated significant increases in support prices for some EU products, most notably grains, that were not reversed when world prices returned to normal levels. Citing serious problems with agricultural surpluses and budget costs and the chaos caused by subsidized exports in the early 1980s, the EU joined other countries in the Punta del Este declaration of the GATT (1985) and later in OECD Ministerial declarations (1987) in calling for multilateral reductions in agricultural support and increased market orientation in agricultural policies. Significant CAP "reforms" have included the following:

1968: Quotas for refined sugar were introduced.

1969: With the CAP hardly fully established, the EU was compelled to manage surplus wheat production by initiating a program to denature wheat, making it unfit for human consumption, and to subsidize its use as feed. Wheat surpluses proved to be a recurring phenomenon.

1982: A principle was adopted that producers should accept less support beyond some threshold production level. "Guarantee thresholds" were adopted for milk, sugar, cereals, rape, and tomatoes for processing. Small support price reductions were indicated but not mandated once production exceeded threshold levels for 3 years.

1984: By the end of 1983, EU stocks of skim milk powder (SMP) totaled almost a million tons (983 kmt), and stocks of butter were only somewhat smaller (853 kmt). The EU was compelled to impose milk delivery quotas. Originally considered temporary, EU milk quotas are still in effect.

1986: Milk quotas were reduced and regulations were imposed on intervention purchasing of milk products and meat, effectively reducing the support price level during periods of serious surpluses.

1988: Again citing growing 'structural' surpluses, rising budget costs, increasing inequalities among farmers in terms of CAP benefits, and endangered international relations, the EU adopted is first general program to deal with 'structural' (i.e. persistent) surpluses (European Commission, 1988). Agricultural 'stabilizers' were adopted for about half of all agricultural production, neglecting only beef among major commodities. Stabilization measures varied by product, but all established a 'maximum guaranteed quantity' (MGQ) of production beyond which support would be automatically reduced. Budgetary discipline was established by limiting the percentage increases in CAP expenditures to no more than three-fourths of the annual percentage increase in the EU's GDP. Effective intervention prices were reduced by stricter rules governing the quantity and minimum quality qualifying for intervention purchasing, shorter fixed periods during which agencies were obligated or authorized to make purchases, and purchase prices below official 'intervention' prices. The Commission declared that "for most products, open-ended buying-in (unlimited government support purchases) is a thing of the past."

1992: Reforms commonly referred to as the MacSharry reforms, after the agricultural commissioner who championed them, represented a major departure for the CAP. The reforms constituted genuine reform in that the need for lower prices finally was addressed. Reforms affecting 75 percent of production were introduced progressively from 1993. Cereal prices were reduced 30 percent, beef prices 15 percent, and dairy product prices 5 percent. Other important changes also were adopted. EU reliance on supply controls (already employed for dairy and sugar) was broadly extended to include mandatory land set-asides for arable crops. The reforms also included a major shift toward support through direct payments and reduced reliance on market price support. Farmers received permanent compensatory payments linked to land use for arable crops to compensate for price reductions. Growing public concern for the environmental impacts of agriculture was addressed for the first time with payments to induce farmers to adopt environmentally favorable production methods.

Although the role of high prices was often recognized as the root cause of surpluses, the political pressure to maintain farm incomes, without significant exception, has always proved politically decisive in CAP reform deliberations. Policies allowing market-directed adjustments in agriculture have never been proposed. Throughout all reforms to date, the CAP has continued to rely on bureaucratic management of fixed prices and progressive extension of production controls.

Additional Reform Pressures

Enlargement. The EU appears firmly committed to the eventual accession of many of the countries of Central and Eastern Europe (CEE) to full membership in the European Union. Enlargement is considered a geopolitical necessity and is expected to provide long-term economic benefits. The release of Eastern Europe from dominance by the former Soviet Union in 1989, the reunification of Germany in 1990, and anticipation of accession of the CEE countries have helped to recapture and reinvigorate the goal and spirit of European unification that had languished during the economic doldrums of the 1980s.

Analysis of enlargement presented elsewhere in this report details the changes in incentives that will result for CEE farmers and the attendant impacts on markets and the EU budget. The expected market impacts are mixed. Enlargement appears likely to aggravate the budget and surplus disposal problems for some commodities while providing some relief for others. The expected impacts on EU agricultural markets are now much less than they were when negotiations began a decade ago. Nonetheless, the budget costs of enlargement for compensatory payments and various rural development schemes are likely to be large.

A Negative CAP Image. The European Commission considers the CAP to have a bad public image on several accounts. The bulk of CAP benefits today accrue to larger, relatively wealthy producers, undermining the CAP's image as a source of assistance to the deserving needy. The public also is aware that high prices have encouraged intensive agricultural practices with seriously adverse environmental impacts. Finally, in response to a general aversion among farmers and the public to the complexity and bureaucratic rigidity of CAP regulations and administration, the Commission included in Agenda 2000 provisions for "a simpler, more understandable agricultural policy" that allows for some decentralization in program decision making in the allocation of EU direct payments.

Emerging Issues. Issues relating to the safety and quality of food and to acceptable methods of agricultural production affecting the environment or animal welfare are considered below. These issues have a growing role in EU agricultural policy deliberations and may lead to new policies affecting agricultural production, consumption, trade, and incomes. Such regulations may significantly affect EU production costs, decreasing EU competitiveness or decreasing EU demand through price increases. How compensation payments to farmers associated with such regulations affect markets and trade will be a major concern for other countries.

The Agenda 2000 proposals and various supporting documents have strived to justify significant direct payments to farmers, regardless of ancillary impacts. Principal among the proposals is a claim for the multifunctional nature of agriculture that requires remuneration to farmers for their role as stewards of the environment and the rural landscape. The Commission has declared that "the fundamental difference between the European model and that of our major competitors lies in the multifunctional nature of Europe's agriculture and the part it plays in the economy and the environment, in society and in preserving the landscape, whence the need to maintain farming throughout Europe and to safeguard farmers' incomes." (European Commission 1997). Most other developed countries, including the United States, are unlikely to accept that "multifunctional" objectives for agriculture are unique to Europe. The successful pursuit of non-trade objectives in agriculture with minimal market and trade distortions can be well documented in non-European countries.

CAP Reform: The Fundamental Dilemma

The Commission has framed the current discussion on CAP reform by declaring the need to "provide a solid basis for ensuring the future development of the EU's agricultural sector." EU policy makers and EU agriculture face at least two realities that shape and limit choices for the CAP in the future. The first is the certainty that productivity in EU agriculture, like productivity in the agricultures of the United States and most developed countries, will continue to increase more rapidly than domestic demand for agricultural goods, ensuring ever increasing surpluses. Globally, agricultural productivity increases in excess of world agricultural demand have led to a decline in real world prices for most commodities. A reduction in EU prices also would cause a temporary reduction in the growth of resource use and production, but increasing productivity would continue to increase production from a lower level.

Expanding exports can provide an outlet for increasing surpluses, offsetting reductions in agricultural employment or production limitations that otherwise would be required and maintaining incomes for a larger farm work force without additional subsidies. However, the second reality facing the EU is that current WTO commitments preclude continued reliance on export subsidies to dispose of inevitable surpluses with internal prices above world prices, and future WTO negotiations may further restrict export subsidies.

Some may consider the severe budget contraints placed on the CAP by Agenda 2000 to be a third reality–CAP spending limits through 2006 are not much greater than current expenditures. That those limits to CAP financing are immutable is not necessarily certain, but budget concerns are the principal issue in Agenda 2000 and pressure appears strong for CAP spending limits that allow very limited growth. On the other hand, CAP budget costs account for less than one-half of one percent of the EU's GDP. In any case, EU agriculture is left with two basic choices.

- *An Agriculture Competitive on World Markets with Expanding Exports.* The EU may lower prices to world market levels, allowing surplus production to be exported without concern for WTO limitations. Expanding exports would offset production restrictions or reductions in agricultural employment that otherwise would be required. As the Commission has argued, long-term prospects for agricultural exports are good. Price reductions adopted in 1992 already have allowed the EU to expand unsubsidized exports of wheat, poultry, pork, and cheese, at least in years of relatively high world prices. Negative impacts of lower prices on EU farm incomes could be ameliorated by increased direct payments, given the political will for adequate budget support. Uncertainty about the stability of political support for direct payments understandably causes many farmers to resist lower prices. Of greatest concern to other countries is the extent to which EU direct payments are decoupled from production decisions, limiting impacts on markets and trade.
- *Managed Agricultural Production and Prices with Limited Exports.* The CAP can keep prices above world market levels by imposing ever more restrictive production controls. In the longer run, employment in agriculture and growth in agricultural incomes will be lower without expanding exports unless government subsidies are significantly increased. Agricultural processing industries also will be limited by high input costs and export subsidy restrictions.

Taking a longer term view in its Agenda 2000 proposals, the Commission opted to move toward a more competitive EU agriculture, building on the principles established in the 1992 reforms. In its Explanatory Memorandum, the Commission declared that "a future in high prices, protectionism and bureaucratic steering of production [will lead] to loss of international markets, falling home consumption and, as a result, declining production in Europe. This model, if it can be called that, may offer short-term comfort but means inevitable decline in the longer run."

Analysis of Agenda 2000 reforms indicates the current reform can only be considered temporary, and at best another step along the uncertain path to a more competitive EU agriculture. Most importantly, the CAP changes already adopted and the Commission's earlier stronger proposal retain a system of managed prices, with no provision for open market-directed adjustments of production and consumption. The limits to economic liberalization inherent in the proposals are clear in the Commission's declaration that the 'European Model of Agriculture' is a "competitive agriculture sector which can *gradually face up* [emphasis added] to the world market without being over-subsidized, since this is becoming less and less acceptable internationally." The Commission's traditional concern for farm incomes is clear in its observation that "seeking to be competitive should not be confused with blindly following the dictates of a market that is far from perfect. The European model is designed to safeguard the earnings of farmers, above all keeping them stable, using the machinery of the market organizations and compensatory payments." The Commission's commitment to market-oriented agriculture clearly remains limited.

In the turn of political events, the momentum toward a competitive agriculture that would have been attained by the Commission's proposals was twice reduced before a final agreement was reached in March 1999 at the European Council in Berlin. A review of the history of CAP reforms

CAP Basics

The following are brief and simplified descriptions of selected important Common Agricultural Policy (CAP) mechanisms:

Arable Crops—Combined with price support for some crops (see cereals), farmers receive direct payments for the cultivation of cereals, oilseeds, protein crops, and potatoes grown for starch in return for compliance with area set-aside requirements.

Compensatory payments——Farmers receive a direct payment for each hectare planted, with oilseeds receiving a much higher payment than cereals and set-aside land receiving an intermediate amount. A limit on total payments is imposed at regional levels, which can reduce per hectare amounts to all farmers. Durum wheat receives a special per hectare payment in addition to compensatory payments. Under Agenda 2000 reforms, payments for oilseed and set-aside area will equal payments for cereals beginning in 2002. These direct payments were called "compensatory" because they were provided in the 1992 reforms in compensation for significantly decreased intervention support prices.

Compulsory set-aside—Farmers are required to leave idle a minimum percentage of their land as a condition of receiving compensatory payments. Set-aside requirements are determined annually in response to market conditions. Set-aside land can be used for production of certain non-food crops. Small farmers producing less than 92 tons of cereals are exempt from set-aside requirements.

Voluntary set-aside——Farmers may voluntarily idle land beyond compulsory requirements and receive the full set-aside payment. Regulations for voluntary set-aside vary by member state.

Cereals—The CAP supports cereals prices by removing supplies in excess of domestic demand through intervention purchasing and the provision of subsidies for export.

Target price—A designated "appropriate" price level for all grains. The target price is not employed in any CAP mechanisms.

Intervention price—the price at which wheat, barley, maize, rye, sorghum, and durum wheat are purchased at intervention, subject to minimum quality standards. Adjustments are made for quality. Minimum standards for wheat exclude feed wheat from intervention. Intervention buying for barley effectively supports feed wheat, oats, and other minor grains indirectly, each obtaining a price in the market reflecting its feed value relative to barley. Monthly increments are added to the intervention price to cover storage costs and insure orderly marketing over the season.

Maximum duty paid import price—155 percent of the intervention price, including monthly increments. Import levies are fixed biweekly for six categories of cereals equal to the maximum duty paid import price minus a representative c.i.f. import price at Rotterdam. Before being abolished in 1995 as part of Uruguay Round WTO commitments, ***variable import levies*** were calculated daily from fixed minimum import prices (***threshold prices***) and the lowest available market prices.

Export "restitutions" or refunds—Export subsidies paid to bridge the gap between world prices and the higher prices in EU internal markets. Export refunds are fixed weekly either as offers at fixed rates or through a tendering process. The provision of export subsidies also serves to support the price of cereals and other products by removing surplus supplies from EU markets before prices are reduced to intervention levels. These export subsidies have been called "restitutions" because they are seen to compensate traders for the high internal cost of exportable supplies.

Oilseeds—EU support for oilseeds is limited to compensatory payments. Oilseed prices are not supported through intervention or export subsidies. Significant separate programs support olive oil.

Maximum guaranteed area—In correspondence with the GATT Panel Agreement of 1992, EU compensatory payments for oilseeds are limited to 5.482 million hectares. A minimum 10 percent set-aside is required to receive payments. If plantings exceed that limit, payments are reduced cumulatively until plantings are within the limit. Set-aside land can be planted to oilseeds for industrial purposes up to a maximum production of 1 million tons of soymeal equivalent.

Projected reference price**—**The EU Commission's forecast for world oilseed prices that serves as the basis for determination of the appropriate compensatory payment for oilseeds. Oilseed compensatory payments are made in two installments, the second of which can be adjusted when the actual world price differs significantly from the Commission's preliminary estimate. This reference price is eliminated in 2000 under Agenda 2000 reforms.

Sugar—The EU provides high prices through guaranteed intervention for refined sugar. Production is subject to quotas. The principal "A" quota is augmented by an additional but much smaller "B" quota for which a reduced price is guaranteed. Export subsidies are provided for A and B sugar not consumed domestically, but production beyond the A and B quotas ("C" sugar) must be exported without subsidies.

Dairy—The EU supports milk prices through intervention buying of the principal milk products and the provision of export subsidies for dairy products. Significant subsidies also are provided for extraordinary domestic consumption of butter and skimmed milk powder (SMP), including feeding of SMP to animals. Because the bulk of EU beef production is a joint product with milk in dairy operations, support for beef also provides significant support for dairy operations.

Delivery quotas**—**Since 1984, producers have been subject to quotas for milk deliveries and sales for direct consumption. Significant penalties are imposed on individual producers if quotas are exceeded.

Intervention milk price equivalent**—**The price of liquid milk that is indirectly supported by intervention buying of butter and SMP.

Private storage aids**—**Subsidies paid to ensure orderly marketing over the marketing year.

Beef and Veal—The EU supports beef prices through intervention subject to specific market conditions. Storage aids are provided to manage seasonal fluctuations, and export subsidies are provided for disposal of surplus production. Producers also receive direct payments.

Normal intervention**—**Intervention purchasing occurs by tendering processes when the EU market price for a particular category of beef is below 84 percent of the intervention price and prices for the same category are below 80 percent of intervention in an individual member state. Normal intervention is limited to 350,000 tons in any year. Normal intervention buying will be eliminated by Agenda 2000 reforms; ad hoc intervention is still provided for at the discretion of the Commission.

Safety-net intervention**—**Extraordinary intervention purchasing when prices are 78 and 60 percent below intervention prices in the EU and an individual member state, respectively. No limit is imposed on safety-net intervention.

Private storage aids**—**Subsidies provided on the condition that a quantity be stored for a designated time in order to deal with seasonal and other market disruptions. Agenda 2000 reforms give a significantly enhanced role for storage aids in management of the beef market.

Headage payments**—**Subsidies paid for male animals at 10 months and 22 months of age, provided the stocking density is 2 livestock units per hectare or less.

Suckler cow premia**—**Paid for retention of suckler cows for 6 months, if the stocking density is 1.5 livestock units per hectare or less. These premia provide support for beef production without providing support to dairy.

Pork and Poultry—The EU provides export subsidies to compensate for high internal cereal feed prices and aids for private storage are provided for pork, but no support through intervention is provided.

makes clear that policy adjustments always have been measured, and generally not much greater than required to deal with immediate problems. The fact is that the 1992 reforms were largely successful, and current EU surplus and budget problems are less severe than those that historically have triggered significant reforms.

Implications for WTO Negotiations

In the Uruguay Round of multilateral trade negotiations, the EU failed to enter into negotiations with a clearly established and practical approach to trade liberalization issues, reducing its eventual influence over the final agreement. Nonetheless, the EU's tenacious position was clearly conditioned by the significant CAP reforms of 1992, which were achieved at great internal political cost. Expecting a continuing trend toward greater liberalization of international agricultural trade, the Commission sought to have CAP reforms that could establish a unified EU position and send a clear signal to other countries concerning the concessions that the EU is prepared to make. The Commission has maintained that "Agenda 2000 is not an opening bid for the WTO negotiations, but rather the policy with which the outcome of these negotiations must be compatible" (Agra Europe Magazine, April 23, 1999).

It is likely that the CAP reforms recently adopted will affect EU negotiating positions, although other countries are not likely to accept them as a blueprint for the next multilateral trade agreement. Analyses of the ways in which Agenda 2000 reforms will condition EU positions in WTO negotiations are presented below. WTO negotiations heighten the significance of agriculture's political strength relative to non-agricultural political forces. EU recalcitrance in agricultural negotiations could be seen as an impediment to the EU's non-agricultural objectives. Additional changes in the CAP will occur when the political and economic costs of not changing it exceed the costs of change.

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